Preqin Research Report

Private Equity Real Estate Funds at End of Investment Period Sitting onn $70-$80 billion in Dry Powder (1)

The boom in private equity real estate fundraising prior to Q4 2008 saw increasing amounts of capital committed to the asset class. However, following the global financial crisis and severe declines in property prices, the number of completed deals has fallen significantly. With a median investment period for real estate funds of three years, many fund managers are now approaching the end of their investment periods with large amounts of capital yet to be invested. For example, vintage 2007 funds have $67 billion in uncalled capital available for investment.

Fig. 1 shows how substantially fundraising for private equity real estate funds grew in the years 2003 to 2008, with the aggregate capital raised in 2008 more than 10 times the amount raised in 2003. Investors, keen to diversify their portfolios and gain exposure to the strong returns that private equity real estate funds were achieving, increased their allocations to the asset class. Rising property prices meant that fund managers found a wealth of opportunities in which to invest committed capital and were typically able to successfully realize their investments within a few years. Investors were therefore receiving regular distributions from their existing portfolio funds and had to continually make new investments to maintain their real estate allocations, further fuelling the fundraising boom.

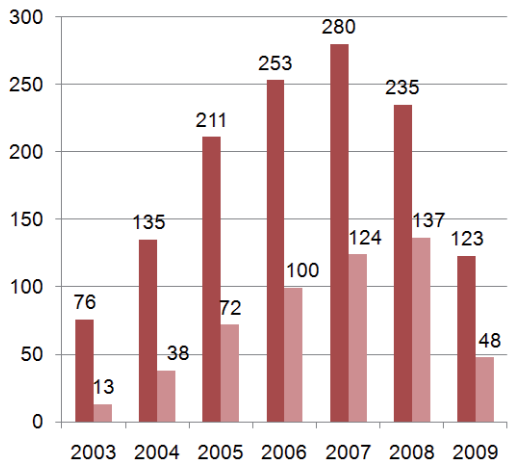
Declining property values worldwide had a significant impact on property transactions during 2009. Falling property values, a lack of available credit and uncertainty about the future of real estate markets meant that many were reluctant to invest capital. This included managers of private equity real estate funds, meaning that they now have a significant amount of capital that was committed during the booming fundraising market but has not yet been called.

Private equity real estate funds have stated investment periods, starting from a fund's first close. Analyzing Preqin's fund terms data shows that such funds have relatively short investment periods compared to other private equity fund types, with a median investment period of three years and a mean of 3.3 years. When real estate values were rising, few fund managers had difficulty finding sufficient opportunities in which to invest their funds' capital within the investment period. However, the rate at which fund managers have called capital has dropped significantly in recent months, which has made it far more likely for fund managers to approach the end of their investment periods with significant levels of capital uninvested. In most cases it is likely that firms will be able to negotiate extensions to the investment period with their investors – provisions for such extensions are present in many limited partnership agreements – but this may not be possible for some, meaning that they would no longer be able to draw down capital for new investments. Such negotiations are likely to become more commonplace during 2010 as more funds approach the end of their original investment periods.

Uncalled Capital

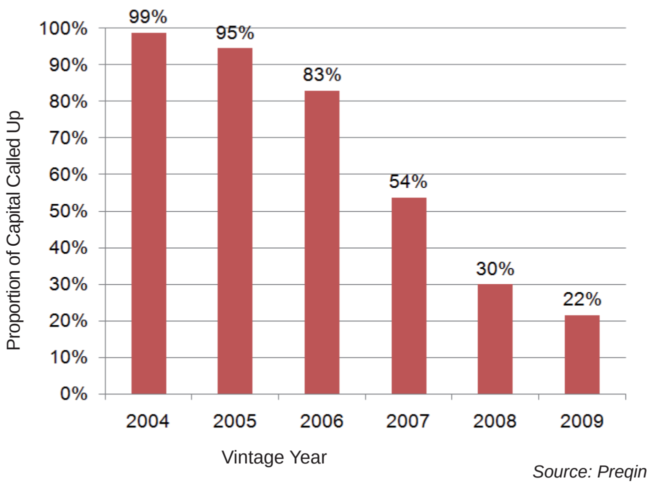
Using Preqin's individual fund level performance data, it is possible to calculate how much capital is still uncalled by funds of different vintage years. Fig. 2 shows the percentage of capital that has been invested by vintage year. Vintage 2007 funds have called up 54% of investor commitments.

Fig. 1: Private Equity Real Estate Fundraising 2003-2009



Source: Preqin

Fig. 2: Proportion of Capital Called Up by Vintage Year



Source: Preqin

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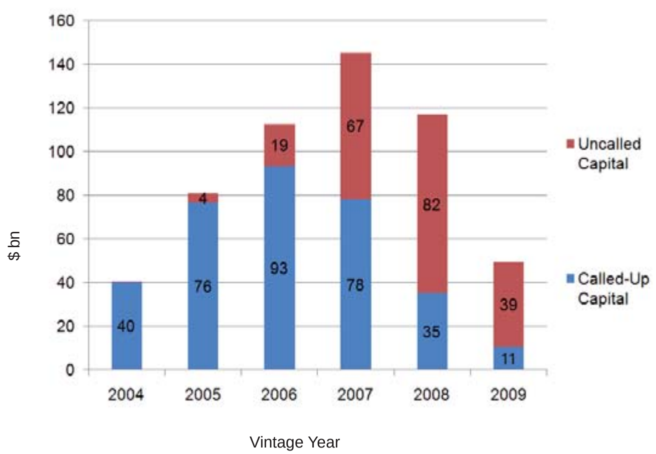
Fig. 3 demonstrates the amount of capital that has been called up and how much is still uninvested. As mentioned, vintage 2007 funds have $67 billion in uncalled capital available for investment. With the median investment period length for real estate funds standing at three years, a significant proportion of this capital is committed to funds nearing the end of their investment periods. There is also $19 billion of uncalled capital from funds of a 2006 vintage, and the vast majority of this capital will be for funds nearing the end of their investment periods.

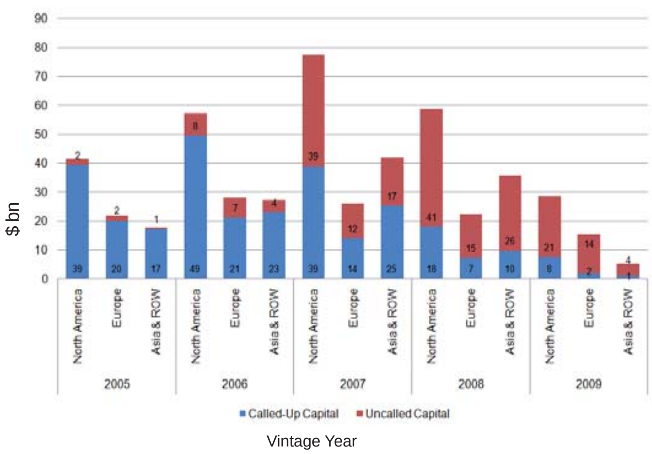
Funds of 2008 vintage have called just 30% of their commitments. Although managers of most of these funds will have more than a year of the investment period remaining, it still represents a significant amount of dry powder that is available to make acquisitions, if the managers of these funds believe that it is a good time to do so. Additionally, some vintage 2008 funds have investment periods shorter than three years. Therefore, in total, it is estimated that funds with an investment period ending in 2010 have $70-80 billion in uncalled capital.

Fig. 3: Called Up vs Uncalled Capital by Vintage Year.



Source: Preqin

Fig. 4: Regional Breakdown of Called vs Uncalled Capital by Vintage Year



Source: Preqin

Regional Breakdown

There appears to be little variation in the percentage of capital that has been called up between different regions. For 2007 vintage funds, North American vehicles are 50% called up, European 54% and Asia and Rest of World 60%. In terms of capital, North American funds of 2006 and 2007 vintages have $46 billion still uncalled. The surge in Asia-focused fundraising that occurred in recent years has resulted in funds of 2006 or 2007 vintages having $21 billion uncalled, while European funds of these vintage years have $19 billion still to invest.

Summary

Real estate firms and investors alike will be extremely reluctant to leave investor commitments uninvested, so it is likely that the investment periods of many funds that had investment periods scheduled to end in 2010 will extend this period for a year or more. There is growing optimism amongst those in the real estate industry and many are anticipating that 2010 will see far more deals being done. Private equity real estate firms certainly have no shortage of capital to invest and so are in a strong position to take advantage of the opportunities in the current market.